93-230

No.

In the Supreme Court

OF THE

United States

Supreme Court, U.S.
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OCTOBER TERM, 1993

CHICAGO BRIDGE & IRON COMPANY,
Petitioner,
v.
BOARD OF EQUALIZATION, STATE OF CALIFORNIA,
Respondent.

On Writ of Certiorari to the Supreme Court of the State of California and the Court of Appeal of the State of California for the Second Appellate District

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Due Process Clause of the Fourteenth Amendment of the United States Constitution is violated by application of the California Use Tax to out-of-state property which is resold to third parties and *never* enters the State of California, where such property (quantifiable scrap steel) was generated as a result of the fabrication, outside the State, of component parts for storage tanks installed in California.

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PETITION FOR WRIT OF CERTIORARI

Petitioner, Chicago Bridge & Iron Company, respectfully prays that a Writ of Certiorari issue to review the opinion of the California Court of Appeal, Second Appellate District, which affirmed the trial court's ruling that Respondent's (California Board of Equalization) application of the California Use Tax to Petitioner's out-of-state property did not violate the Due Process Clause of the Fourteenth Amendment.

OPINIONS BELOW

A copy of the Opinion and Judgment of the Court of Appeal, dated February 26, 1993, from which this appeal is taken, is reproduced at Appendix "A". A copy of the Order of the Court of Appeal Denying Rehearing, dated March 19, 1993, is reproduced at Appendix "B". Neither the judgment nor the Order on Rehearing were published in either the official or the unofficial reports of California.

A copy of the Order of the California Supreme Court Denying Petition for Review, dated May 18, 1993, is reproduced at Appendix "C". The California Supreme Court's Order was not published in the California reports.

A copy of the Joint Stipulation of Facts filed in the State trial court proceeding, dated May 1, 1990, is reproduced at Appendix "D". A copy of the Judgment of the State trial court, dated June 4, 1990, is reproduced at Appendix "E". Neither of these documents was published.

A copy of Appellant's Notice of Appeal to the State Court of Appeal from the Judgment of the State trial court, filed July 6, 1990, is reproduced at Appendix "F".

JURISDICTION

The Court of Appeal rendered its opinion and judgment on February 26, 1993, affirming the judgment of the California trial court. A Petition for Rehearing was filed March 15, 1993, and was denied by the Court of Appeal on March 19, 1993. Petitioner's Petition for Review by the California Supreme Court was filed April 7, 1993 and was denied by Order dated May 18, 1993. This Petition for Writ of Certiorari is filed within 90 days of that Order as required by 28 U.S.C. § 2101(c).

Absent positive assurance to the contrary from the California Supreme Court, the denial by that Court of the Petition for Review is considered to be a decision on the merits from which an appeal properly lies. *R.J. Reynolds Tobacco Co. v. Durham County,* 479 U.S. 130, 138-139, 93 L.Ed.2d 449,460-461, 107 S.Ct. 449 (1986).

The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS

The relevant portion of the United States Constitution is the Due Process Clause of the Fourteenth Amendment which provides in pertinent part as follows:

> "... nor shall any state deprive any person of ... property ... without due process of law; ..." [U.S.C.A. Const. Amend. XIV, Sec. 1].

During the years at issue, Section 6201 of the California *Revenue & Taxation Code* provided as follows:

> "An excise tax is hereby imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer on or after July 1, 1935, for storage, use, or other consumption to this state at the rate of 3 percent of the sales price of the property, and at the rate of 1½ percent on and after July 1, 1943, and to and including June 30, 1949, and at the rate of 3 percent on and after July 1, 1949, and to and including July 31, 1967, and at the rate of 4 percent on and after August 1, 1967, and to and including June 30, 1972, and at the rate of 3¾ percent on and after July 1, 1972, and to and including June 30, 1973, and at the rate of 4¾ percent on and after July 1, 1973, and to and including September 30, 1973, and at the rate of 3¾ percent on and after October 1, 1973 and to and including March 31, 1974, and at the rate of 4¾ percent thereafter." [Added Stats. 1972 ch. 1406 § 19, effective December 26, 1972, operative June 1, 1973; Amended Stats. 1973 ch. 67 § 3, effective May 29, 1973, operative July 1, 1973, ch. 2296 § 6, effective August 23, 1973, operative October 1, 1973.]

Section 6009 of California *Revenue & Taxation Code* provides as follows:

> " 'Use' includes the exercise of any right or power over tangible personal property incident to the ownership of that property, and also includes the possession of, or the exercise of any right or power over, tangible personal property by a lessee under a lease, except that it does not include the sale of that property in the regular course of business." [Added Calif. Stats. 1941, Ch. 36, Section 1, effective July 1, 1943; Amended Stats. 1st Ex. Sess. 1965, Ch. 2, Section 5, effective July 12, 1965, operative August 1, 1965.]

Section 6017 of California *Revenue & Taxation Code* provides as follows:

> " 'In this State' or 'in the State' means within the exterior limits of the State of California and includes all territory within these limits owned by or ceded to the United States of

America." [Added Calif. Stats. 1941, Ch. 36, Section 1, effective July 1, 1943.]

The relevant portion of California Regulation 1521(b)(6)(C), 18 *Cal. Code of Regulations*, provides as follows:

> "A contractor may claim a 'tax paid purchases resold' deduction for any property of which he is the retailer when he has reimbursed his vendor for tax which the vendor is required to pay to the State or has paid the use tax with respect to the property, and has resold the property prior to making any use of it. In the event that the contractor sells short ends or pieces which are not used other than in severing them from larger units purchased by him and to which he has paid sales tax reimbursement or use tax, he may claim the deduction for tax-paid purchases resold, but the amount of the deduction shall not exceed the price at which he sells such short ends or pieces." [Regulation 1521(b)(6)(C), 18 *Cal. Code of Regulations.*]

STATEMENT OF THE CASE

A. Procedural Background

Petitioner timely filed its California Sales and Use Tax returns with Respondent for all quarters of each year in the relevant time period (January 1, 1978 through December 31, 1982). Following an audit of Petitioner's Use Tax returns, Respondent refused to allow Petitioner a full deduction from its California Use Tax base[1] of the cost to Petitioner of scrap steel purchased and resold by Petitioner *entirely outside the State of California* (the "scrap steel").

The parties agreed that because Petitioner was a construction contractor, under California law Petitioner was the consumer for use tax purposes of any material that it furnished and installed inside California in the performance of a construction contract.

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[1] Petitioner's California Use Tax base is the sales price to Petitioner of all tangible personal property used, stored or consumed by it in California. Cal. *Rev. & Tax. Code* § 6201.

Regulation 1521(b)(2)(A), 18 *Cal. Code of Regulations*. The parties disputed the State's unconstitutional *application* of its use tax to Petitioner's out-of-state property and the resulting improper computation of the cost base upon which Petitioner's California Use Tax was to be computed.

Petitioner paid the full amount of the tax deficiency assessed as a result of Respondent's recomputation of Petitioner's Use Tax base and then filed claims for refund with Respondent for recovery of the additional California Use Tax paid.

Respondent denied Petitioner's refund claims, disagreeing with Petitioner's contention that Respondent's refusal to reduce Petitioner's California Use Tax base by the dollar amount of the cost to Petitioner of scrap steel that was bought and sold outside the State of California and never used in any manner or for any purpose inside the State was contrary to the Due Process Clause and not supported by California law. Respondent argued that the reduction of Petitioner's California Use Tax base as a result of the sale by Petitioner of scrap steel generated outside the State of California to third-parties also outside the State of California was limited to the dollar amount that Petitioner realized in sales to these out-of-state dealers. The Board cited the "short-ends" rule of Regulation 1521(b)(6)(C), 18 *Cal. Code of Regulations*.

Petitioner then sued for recovery of California Use Tax pursuant to California *Revenue & Taxation Code* § 6933. After the parties filed concurrent motions for summary judgment, the trial court entered an order granting Respondent's motion and denying Petitioner's.

Petitioner appealed from the trial court's order. The Court of Appeal affirmed the judgment of the trial court and denied Petitioner's Petition for Rehearing. The California Supreme Court then denied Petitioner's Petition for Review of the Court of Appeal judgment.

Petitioner raised the federal question of whether Respondent's application of the use tax to Petitioner's out-of-state property violated the Due Process Clause of the Fourteenth Amendment in its complaint for recovery of California Use Tax. In its Order

granting Respondent's Motion for Summary Judgment, the California trial court did not address the Constitutional issue.

Petitioner raised the due process issue again on appeal, but was given short shrift in the Appellate Court's decision:

> "We summarily reject [Petitioner's] contention that the [Respondent's] reliance on Regulation 1521(b)(6)(C) to support its application of a use tax in this case deprives [Petitioner] of its due process rights. Aside from the fact that the regulation benefits [Petitioner] by creating a *deduction* for scrap resale proceeds, it is absolutely consistent with the Supreme Court's interpretation of the statute. [Respondent] is relying on the statute, as interpreted by the courts, not on a regulation." *Chicago Bridge & Iron Co.*, No. BO51542, Slip Op. at 9.

B. Factual Background

The parties do not dispute the relevant facts which are contained in the Joint Stipulation of Facts (Exhibit "D"). These facts are summarized as follows:

1. Petitioner's Business Operations

Petitioner is, and at all times material here was, an Illinois corporation whose principal headquarters and place of business are in Oak Brook, Illinois. During the relevant time period (January 1, 1978 through December 31, 1982), Petitioner was qualified to do business in the State of California and performed some of its business operations there.

Petitioner's principal business operations and activities during this period consisted of the design, engineering, manufacture and field installation of large steel plate storage tanks, for the processing and storage of petroleum products, chemicals and other liquids.

2. Petitioner's California Contracts

Petitioner performed a number of contracts in California that required the on-site installation of large storage tanks. Except for the actual installation of these tanks at the field sites in California,

most, if not all, of the services performed by Petitioner in connection with these California construction contracts were rendered at Petitioner's fabrication plant in Salt Lake City, Utah.

3. The Unused Scrap Steel Never Entered The State of California In Any Form

Notwithstanding Petitioner's efforts to minimize its costs by reducing unused steel plate, a certain amount of unused steel plate necessarily resulted from the cutting, rolling and manufacture of subassemblies which, when assembled, made up the storage tanks installed at various construction locations in California.

That portion of the unused steel treated by Petitioner as scrap steel was later sold by Petitioner to local Utah scrap dealers[2] and constitutes the subject matter of this dispute. *The scrap steel at issue here was neither purchased nor sold, nor used, stored or consumed in California.*

4. Petitioner Has Accurately Quantified The Cost Of The Scrap Steel Sold To Local Utah Scrap Dealers

It is undisputed that Petitioner has accurately determined the cost of the scrap steel. The cost of the scrap steel is precisely computed by substituting from the total volume of material purchased *outside* the State of California the exact weight of the subassemblies exported from the Utah plant to various California construction sites. The cost of the scrap steel is then determined by multiplying the weight of the scrap steel which remained at the Utah plant by the actual cost per pound of the material.

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[2]Petitioner's sales to local Utah scrap dealers were not taxable transactions since they were not "retail sales" as that term is defined in Calif. *Rev. & Tax. Code* § 6091. Petitioner received resale certificates from the Utah scrap dealers establishing that the scrap steel was purchased for resale. Whenever the scrap steel was eventually sold at retail it was subject to the pertinent sales or use tax, but that transaction is irrelevant here.

5. Petitioner's Position

Petitioner contends that its method of ascertaining the cost of materials actually imported into the State of California accurately reflects its true cost of the materials stored, used or consumed within the state. Petitioner contends further that, based upon its ability to accurately compute the cost to it of materials actually stored, used or consumed in the State of California, and based upon its purchase and resale of scrap steel wholly outside the State of California, Petitioner's California Use Tax base should be limited to the actual cost to Petitioner of materials used, stored or consumed in the state. Obviously such materials do not include the out-of-state scrap steel.

6. Respondent's Position

Respondent contends, on the other hand, that the California "short-ends" Regulation 1521(b)(6)(C), 18 *Cal. Code of Regulations*, applies to the resale by Petitioner of scrap steel to third-party scrap dealers outside the State of California and thus Petitioner's California Use Tax base should include the cost of material that never enters the state reduced only by its resale value.

REASONS FOR ALLOWING WRIT

A. The Court of Appeal Has Decided An Important Question of Federal Law Which Has Not Been, But Should Be, Settled By This Court

The California Court of Appeal has held that the State of California may, without violating the Due Process Clause of the Fourteenth Amendment, impose its use tax upon out-of-state property that never enters the State. *Chicago Bridge & Iron Co.*, No. BO51542, Slip Op. The Appellate Court's decision is a matter of first impression which has not been, but should be, settled by this Court. If not reversed, the decision would undercut the protection afforded taxpayers by the Due Process Clause, both because of the uncertainty it would spawn and because of the costs it would impose without warning.

The decision below has significance beyond the borders of California and far beyond the liability of an out-of-state construction contractor for use tax on out-of-state property. It potentially affects the ability of all businesses — no matter where located — to compute their cost of doing business out-of-state and therefore to competitively engage in interstate commerce. The spurious reasoning of the Appellate Court's decision encourages an unprecedented expansion of the Due Process Clause insofar as it would permit a State to tax property outside its taxing jurisdiction.

The Court of Appeal fails to cite any authority of this Court in support of its ruling. It relies solely upon the California Supreme Court decision of *Chicago Bridge & Iron Co. v. Johnson*, 19 Cal. 2d 162 (1941) but does so in error. The *Johnson* decision does not dispose of or even address the question presented here.

This Court has addressed the question whether a State may require an out-of-state seller to collect and pay a use tax on goods purchased for use within the State (*See, e.g., Quill Corp. v. North Dakota*, 504 U.S. ____, 119 L.Ed.2d 91, 112 S.Ct. 1904 (1992)), but that issue is altogether different from the question presented here. *Quill* and its predecessors dealt with whether State regulatory jurisdiction could be asserted against an out-of-state seller based upon that seller's physical presence or lack thereof in the taxing State. The Court determined in *Quill* whether North Dakota's use tax could be imposed against an out-of-state mail-order house that had neither outlets nor sales representatives in North Dakota. Using reasoning comparable to that contained in its post-1967 cases dealing with state jurisdiction to adjudicate, the Court held that the Due Process Clause does not require the physical presence of the seller in a State for the State to impose the duty of use-tax collection.[3] *Quill*, 504 U.S. at ____, 119 L.Ed.2d at 103, 104, 112 S.Ct. 1904.

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[3]Although the Court concluded in *Quill* that the Due Process Clause does not bar a state from imposing its use tax upon a seller whose only connection with the State is through common carrier or the United States mail, it found that the State's enforcement of the use tax against the out-of-state seller placed an unconstitutional burden on interstate

The question presented here represents the flip-side to *Quill* and its predecessors. This case does not concern a link or minimum connection between the taxing state (California) and the out-of-state taxpayer (Petitioner). Petitioner does not dispute that it qualified to carry on an interstate business in California, or that it purposefully availed itself of the benefits of California's economic market. Rather, this case involves the proper composition of the tax base which serves as the measure of California's use tax and whether California has unconstitutionally subjected Petitioner's property to extraterritorial taxation in violation of the Due Process Clause by including in that use tax base value attributable to property (the scrap steel) which has never been stored, used or consumed within California's borders.

Thus the specific question presented here has never been settled by this Court. This Court has addressed whether sufficient contacts exist between a *taxpayer* and a State to satisfy the "nexus" requirements of the Due Process Clause (*Quill* and its predecessors), but it has never determined the extent to which those contacts must exist between the *property* to be taxed and a State to satisfy due process concerns. Specifically, this Court has never addressed whether the Due Process Clause bars application of a State's use tax to out-of-state property that never enters the State, where such property is purchased out-of-state along with other materials which are subsequently used to construct finished products (storage tanks here) which come to rest in the taxing state.

This is similarly a case of first impression in California. The Court of Appeal contends that the California Supreme Court's decision in *Johnson* is dispositive of the question presented here

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commerce. The Commerce Clause is not at issue here since it is not disputed that the use tax may be levied on things acquired or transported in interstate commerce once they are at rest and have become part of the common mass of property within the state of destination. *Henneford v. Silas Mason Co.*, 300 U.S. 577, 582, 81 L.Ed. 814, 818 57 S.Ct. 524 (1937). The scrap steel at issue never entered or came to rest in California at any time, hence Petitioner focuses on the Due Process Clause, which *Quill* noted is subject to its own distinct test. *Quill*, 504 U.S. at ____, 119 L.Ed. at 102, 1125 S.Ct. 1904.

and that *Johnson* "expressly rejected" Petitioner's argument that it can only be taxed on property that is used, stored or consumed in California. *Chicago Bridge & Iron Co.*, No. BO51542, Slip Op. at 5, n. 2. But the Court of Appeal is wrong.

The decision below misreads *Johnson* which held only that the California Use Tax applies to materials stored in California just prior to and during their installation there. *Johnson*, 19 Cal.2d at 167. *Johnson* did not address whether the use tax would similarly have applied if the materials had never entered the State. Yet the Court of Appeal infers from *Johnson* that property which never enters the State should nevertheless be included in the use tax base so long as that property is initially purchased with other materials used to construct storage tanks in the State.[4]

Although *Johnson* involves both the same taxpayer as this case and a use tax issue, it is not analogous. Whereas in *Johnson* Petitioner argued (incorrectly) that the use tax should not have been applied to property it conceded was stored in California because that property was only manufactured and not purchased by it (*Johnson*, 19 Cal.2d at 167, 170),[5] Petitioner argues here that *the use tax should not be applied to property that is conceded by both parties never to have entered the State at all.*

Contrary to the Appellate Court's assertion, *Johnson* did not reject (or even address) the venerable principle at risk here: that due process requires a "definite link, some minimum connection, between a state and the ... property ... it seeks to tax." *Miller*

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[4]The Court of Appeal further misreads *Johnson* when it claims that the regulation at issue (1521 (b)(6)(c)) "benefits [Petitioner] by creating a deduction for scrap resale proceeds." *Chicago Bridge & Iron Co.*, No. B051542, Slip Op. at 9. Rather than "creating" a deduction from Petitioner's use tax base, the regulation, as *applied* by Respondent, unconstitutionally *limits* a deduction (on account of the cost to the Petitioner of the scrap steel) to which Petitioner would otherwise be entitled.

[5]Since the *Johnson* decision, Petitioner has paid use tax without argument on all materials used, stored or consumed by it in the State regardless of whether Petitioner purchased or manufactured those materials.

Bros Co. v. Maryland, 347 U.S. 340, 344-345, 98 L.Ed. 744, 94 S.Ct. 535 (1954). Conspicuously absent from the decision below is the following statement from *Johnson* (at 170) which should have removed any ambiguity as to whether the California Supreme Court "expressly rejected" Petitioner's argument that it can only be taxed on property used, stored or consumed in the State:

> "The tax was levied on the storage and use of materials which were purchased and fabricated into the tank parts, *that storage and use consisting of the time after the materials had arrived [in California]* . . . . That was the commencement of the taxable moment; that was the taxable intrastate event which occurred after the interstate transit had ceased." (emphasis added)

Here, no "taxable intrastate event" ever occurred because "interstate transit" of the scrap steel, from Utah to California, never took place.

That the Court of Appeal was unable to distinguish the issues raised in *Johnson* from those raised in the present case only reinforces the need for this Court to provide clarity on this important Constitutional question. Although the *Johnson* decision is not inconsistent with Petitioner's position, it does not address whether the State's application of the California Use Tax to out-of-state property violates the Due Process Clause. If the Appellate Court's decision is allowed to stand absent this Court's review, California and other states may continue expanding the reach of the use tax to extraterritorial property, thereby undermining the Due Process Clause.

B. The Court Of Appeal's Decision That California May Apply Its Use Tax To Scrap Steel Generated And Resold Outside The State Conflicts With Established Constitutional Principles As Articulated In The Decisions Of This Court

That a State may not tax value earned outside its borders is an established principle of constitutional law. *Asarco, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315, 73 L.Ed.2d 787, 794, 102 S.Ct. 3103 (1982); *Connecticut General Life Ins. Co. v. Johnson*, 303 U.S. 77, 81-81, 82 L.Ed. 673, 58 S.Ct. 436 (1938). The Due

Process Clause requires some "definite link, some minimum connection, between a state and the . . . property . . . it seeks to tax." *Miller Bros. Co.*, 347 U.S. at 344-345, 98 L.Ed. 744, 74 S.Ct. 535.

Here, the failure of the scrap steel ever to enter California belies a "link" or "minimum connection" between California and Petitioner's alleged "use" of the scrap steel in California. While it is conceded that Petitioner qualified to and did carry on an interstate business in California, thus establishing a nexus between the State and Petitioner, the Constitutional analysis does not end there. This Court has held that even when a nexus exists between the State and the taxpayer, if the State fails to otherwise comply with the requirements of due process, then the nexus between the State and the taxpayer is fortuitous and the State may not tax or otherwise burden transactions that are entirely disassociated from the local business. *American Oil Co. v. Neill*, 380 U.S. 451, 458-59, 14 L.Ed.2d 1, 85 S.Ct. 1130 (1965); *see also Connecticut General*, 303 U.S. at 80-81, 82 L.Ed. 673 ("a state which controls the property and activities within its boundaries of a foreign corporation admitted to do business there may tax them. But the Due Process Clause denies to the State power to tax or regulate the corporation's property and activities elsewhere").

The scrap steel bought and sold by Petitioner outside the State is wholly beyond the reach of California's sovereign power. It is a transaction that California cannot effectively command without running afoul of the Due Process Clause:

> "No principle is better settled than that the power of a State, even its power of taxation, in respect to property, is limited to such as is within its jurisdiction . . . . If the legislature of a State should enact that the . . . property of another State . . . should be taxed in the same manner as the . . . property within its own limits and subject to its authority, or in any other manner whatsoever, such a law would be as much a nullity as if in conflict with the most explicit constitutional inhibition." *Miller Bros. Co.*, 347 U.S. at 342, 98 L.Ed. 744, 74 S.Ct. 535.

Respondent may argue that the decision below does not conflict with prior decisions of this Court; that the issue here is simply one of statutory construction; and that the scrap steel was effectively used or consumed in California because it was generated, albeit out-of-state, as a result of fabricating activities associated with the performance of contracts involving California destinations. But any attempt to limit this case to a question of statutory interpretation obfuscates the practical effect of the State's application of the use tax to these facts: the operative reach of the use tax statute as applied embraces extraterritorial property and therefore violates the Due Process Clause. *See Union Refrigerator Transit Co. v. Kentucky*, 199 U.S. 195, 204, 210, 50 L.Ed. 150, 153, 156 (1905) (it is "essential to the validity of a tax that the property shall be within the territorial jurisdiction of the taxing power;" and "the adoption of a general rule that tangible personal property in other states may be taxed at the domicile of the owner involves possibilities of an extremely serious character").

This Court has held that when passing on the Constitutionality of a State taxing scheme its primary concern is with the practical operation of the tax — substance rather than form. *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 443-444, 85 L.Ed. 267, 270, 61 S.Ct. 246 (1940). A determination of the ultimate effect of the law as applied and enforced by the State is required. *Connecticut General Life Ins. Co.*, 303 U.S. at 80, 82 L.Ed. 673, 58 S.Ct. 436. Here, the ultimate and practical effect of both the State's application of its use tax and the affirmation of that application by the decision below is to permit the State of California to violate the Due Process Clause by taxing property wholly outside its jurisdiction.

DATED: August 11, 1993

Respectfully Submitted,

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